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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

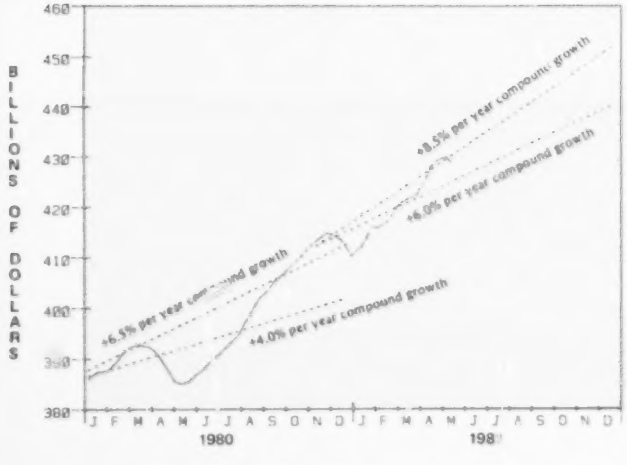
MONDAY, JUNE 8, 1981 VOLUME XVIII, NUMBER 23

The Signals Appear To Indicate . . .

A variety of favorable economic and financial developments has recently heightened speculation that short-term interest rates may be either near, or at their peaks for the current economic cycle. These include an easing of money supply growth and business loan demand at the nation's commercial banks, a spreading weakness in the pace of economic activity and a marked reduction in the rate of inflation. And if the weakening economy and lower rates of inflation should dampen monetary growth even further in the weeks ahead, good-sized rallies in the money, bond and equities markets are possible.

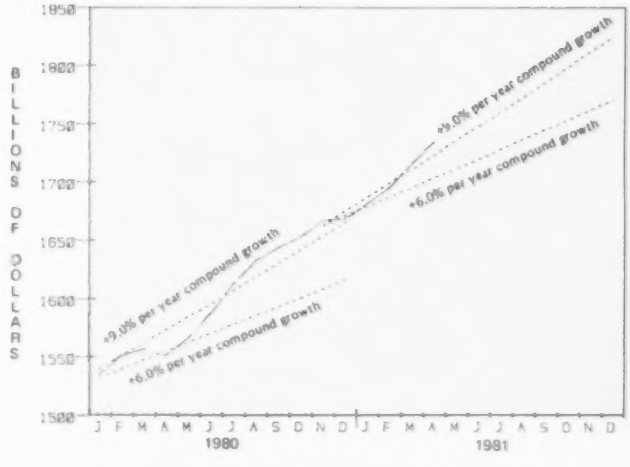
Perhaps the most important development in recent weeks has been the substantial slowing of money supply growth. During the month ending May 20, for example, M-1B expanded at a modest 1.1 per cent seasonally adjusted annual rate, a significant deceleration, compared with the more than 20 per cent annual rate of rise posted during the month ending April 29. As a result, and as shown in the chart below, M-1B is now well within its 1981 target boundaries.

MONEY SUPPLY, M-1B
FOUR-WEEK MOVING AVERAGE



Even with the growth of the money supply turning sluggish and expectations that it will remain that way as the economy softens, there has been little indication that the Federal Reserve may be about to relax its tight grip on the monetary reins. Indeed, with the central bank moving aggressively to drain reserves from the banking system early last week while the Federal funds rate hovered near the upper end of its presumed 15 to 20 per cent target band, the Fed clearly reemphasized its determination to keep money supply growth throttled back.

MONEY SUPPLY, M-2



Since M-1B growth is now expanding within its target ranges, the focus of monetary restraint has to be the curbing of the growth of the broader money measure, M-2. Federal Reserve spokesmen have recently begun advising bankers and other money market participants to pay more attention to M-2. However, M-2 is rising rapidly so far this year (see chart above). But with funds now flowing directly into such money market instruments as Treasury bills and stocks, and away from such components of M-2 as NOW accounts and money market funds, M-2 growth should soon decelerate, returning this aggregate to its target band by early this summer.

Until this slowing is visible, there is little reason to expect the adoption of a more accommodative monetary policy. This was not the conclusion that apparently was reached by those financial market

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participants who remain riveted to the fluctuations in M-1B. Anticipation of less monetary restraint due to the curtailment of M-1B growth quickly turned to disappointment, and an expected strong money market rally failed to materialize in early June.

. . . That Short-Term Interest Rates . . .

As long as monetary policy remains restrictive, any interest rate declines will have to come from demand-side, rather than supply-side, factors. Thus, the pace of economic activity and the rate of inflation—and their corresponding impact on the demand for money and credit—become key elements in the financial market outlook. In the economy, the evidence continues to mount that the expansion of the "real" GNP in the second quarter will be substantially less than the torrid, 8.4 per cent seasonally adjusted annual rate of rise posted in the first quarter—if there is any growth at all. Among the more recent indicators of a fading of the growth momentum was the modest 0.4 per cent month-over-month increase in the index of leading economic indicators in April, following a sharp 1.8 per cent gain the month before; the continuing sluggish pace of automobile sales since the elimination of the rebates; the steep plunge in new home sales in April and an easing of new factory orders, for both

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 5/27/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov't and Agencies Owned Outright & RPs	128.832	– 1.475	– 1.107
Loans to Depository Inst.	2.923	+ .948	+ 1.799
Float	2.497	– .547	– 1.009
Total Reserve Bank Credit	144.121	– 1.057	+ 4.523
Treasury Deposits with Federal Reserve Banks	2.830	– .289	+ .216
Currency Outside Banks	122.621	– .485	+ 8.359
Member Bank Reserves:			
Required	39.810	– .546	– 3.804
Excess (Deficiency)	.583	+ .379	+ .597
Total Reserves Held	40.393	– .167	– 3.207
Net Borrowed Reserves	2.031	+ .531	+ .922
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	97.516	– 2.546	+22.639
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M-1A	363.5	– 1.9‡	– 0.8‡
M-1B	427.4	+ 9.8‡	+ 10.6‡
M-2 (April '81)	1,734.9	+ 12.7	+ 11.8
L (February '81)	2,421.5	+ 12.7	+ 10.4

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 6/5/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	15.55%	14.20%	13.30%
* Federal Agencies	15.10	15.40	15.30
* Project Notes–Taxfree (46% Taxable Equivalent)	12.96	13.89	13.15
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	17.75	16.75	

‡Finance Company Paper–Prime

5- 14 days	18.25%
15- 29 days	18.38
30- 59 days	17.75
60- 89 days	16.00
90-179 days	15.00
180-239 days	15.00
240-270 days	12.00

‡* Bankers' Acceptances

Jul.	18.50%
Aug.	17.20
Sep.	16.60
Oct.	16.40
Nov.	15.40
Dec.	15.10

‡Industrial Paper–Prime

30- 89 days	18.50%
90-120 days	17.00

†Federal Funds Effective Rate 20.00%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'81	$ 2,854	$ 2,731	$ 2,572
Gross National Product (1972 Dollars)*	1st Q'81	$ 1,516	$ 1,486	$ 1,502
Percent Change, Annual Rate	1st Q'81	8.4%	3.8%	3.1%
Change in Consumer Prices (all urban consumers)*	Apr '81	4.8%	7.2%	10.8%
Change in Producer Prices*	May '81n	4.8%	9.6%	6.0%
Civilian Employment (Thousands of Persons) †	May '81n	99,235	98,976	97,116
Unemployment as % of Civilian Labor Force †	May '81n	7.6%	7.3%	7.6%
Personal Income*	Apr '81	$ 2,351	$ 2,338	$ 2,102
Leading Indicators Composite Index (1967=100) †	Apr '81	138.3	137.8	126.2
Industrial Production Index (1967=100) †	Apr '81	152.8	152.2	148.3
Net Change in Consumer Installment Credit †	Apr '81n	$ 2.33	$ 3.11	–$ 1.67
U.S. Merchandise Trade Balance†	Apr '81n	–$ 2.47	$ 0.49	–$ 1.20
Plant and Equipment Expenditures*	2nd Q'81	$317.29(a)	$310.59(a)	$294.36
Private Housing Starts (Thousands of Units)*	Apr '81	1,343	1,289	1,044
New Construction Expenditures*	Apr '81n	$ 244.6	$ 251.5	$ 225.8
Total Business Inventories†	Mar '81	$ 471.8	$ 470.8	$ 443.0
Total Business Sales†	Mar '81	$ 345.9	$ 346.4	$ 310.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

durable and nondurable goods, also in April.

Nor is any sustained turnaround of these trends likely to occur soon. Automobile sales will remain depressed as buyers find themselves increasingly deterred by escalating sticker prices and lofty finance charges. New housing starts cannot help but slump further in response to the inability of builders to sell existing new homes and the massive disintermediation that has been occurring at the nation's thrift institutions, which will make mortgage markets even less accommodating to prospective homebuyers. Even industrial production and total employment, which have so far exhibited a persistent resiliency, will undoubtedly falter if new factory orders continue to ease. All the signs add up to an economy whose growth momentum may have already halted.

. . . May Have Already Peaked

The sluggish economy will ease upward interest rate pressures by reducing the demand for funds. It will also dampen upward price pressures. The rate of inflation has already declined substantially from year-ago levels when measured by every price index, and even more gains are likely to come. The continuing surplus of global oil supplies is now exerting

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (5/20/81)	119,019	+ 976	+23,826
New York City (5/20/81)	28,507	– 401	+ 6,230
Commercial Paper (5/20/81)	142,564	+ 500	+16,810

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/20/81)	174,863	– 668	+16,995
New York City (5/20/81)	50,955	– 430	+ 4,726

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/20/81)	431,930	– 1,382	+38,088
New York City (5/20/81)	101,959	– 858	+13,355

Financial Markets

	Friday 6/5/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	16.57%	+ 1.58	+ 9.03
180-Day Bills†	16.00	+ 2.00	+ 7.88
Longest Bills†	15.17	+ 2.02	+ 6.70
Recent Issues:			
15⅝s 5/31/81	15.40	+ 2.22	
13⅜s 3/31/85	12.98	– 1.02	
14½s 5/15/91	13.81	+ .39	
13⅞s 5/15/11	13.96	+ .96	
Municipals:			
Bond Buyer–20 Bond Index* (6/4/81)	10.59%	– .05	+ 2.92
Blue List Total ($ Million)	$ 820	– $ 24	– $ 127
30-Day Visible Supply ($ Million)	$2,167	+ $351	+ $ 86
Total	$2,987	+ $327	– $ 41
Corporates:			
Moody's Aa Composite (6/4/81)	14.72%	– .24	+ 2.87
Money Mgr.–30-Day Supply ($ Million)	$6,369	+ $ 95	+ $3,546
Stocks:			
Dow-Jones Averages:			
Industrials	993.79	+ 2.04	+ 132.27
Transportation	426.28	– 9.51	+ 148.19
Utilities	105.70	– 1.97	– 4.38
65 Stocks	383.83	– 3.31	+ 70.89
Standard and Poor's 500 Stocks	132.10	– .49	+ 18.90
N.Y.S.E. Composite Index	76.73	– .26	+ 12.06
N.Y.S.E. Avg. Daily Vol. for Week (000's)	54,040	+ 827	21,398

* 46% Taxable equivalent 19.61%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 6/5/81	Week Ago
Overnight	19.38%	17.50%
1 month	19.00	17.81
3 month	18.50	17.63
6 month	17.38	16.75
1 year	16.50	16.13
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	14.75%	14.80%
Long Term (7 to 15 yrs.)	14.60	14.55

FOREIGN EXCHANGE SPOT RATES

New York Opening (6/5/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02527	39.58
Canada	.8266	1.2098
Denmark	.1307	7.6500
France	.1739	5.7500
Germany	.4118	2.4285
Italy	.0008271	1209.00
Japan	.004375	228.60
Mexico	.04122	24.26
Netherlands	.3704	2.7000
Switzerland	.4666	2.1430
U.K.	1.9310	.5179

significant downward pressures on crude oil prices. What is more, adequate crop and livestock supplies should preclude another food price surge for a while and the depressed condition of the nation's housing market will put a lid on home price increases.

But the confluence of favorable factors now affecting the inflation outlook does not only include food and energy price moderation. The soaring external value of the dollar, for example (Financial Digest—June 1, 1981), should reduce the cost of imported goods and services, while higher carrying costs have already encouraged financial asset acquisition at the expense of purchases of precious metals and other commodities. This, together with some abatement of inflation expectations, has already contributed to the decline in commodities' prices over the past half year. The BLS spot price index of all commodities at the end of May stood almost 11 per cent below its early-November, 1980 peak, while the industrial metals index has declined by almost eight per cent during the period.

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How the Surplus Builder works.

This new design actually allows the Dedicated Bond Portfolio to benefit from rate fluctuations over the investment period. How? By building a surplus of assets, usually achieving a rate of return greater than available in today's market.

Even as interest rates fluctuate, the portfolio should build surplus. Because a proper balance is monitored throughout the investment period. Thus, the actual rate of return realized at period's end should exceed the targeted minimum rate of return–thanks to the swapping flexibility of the new design.

How the Matched Portfolio works.

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